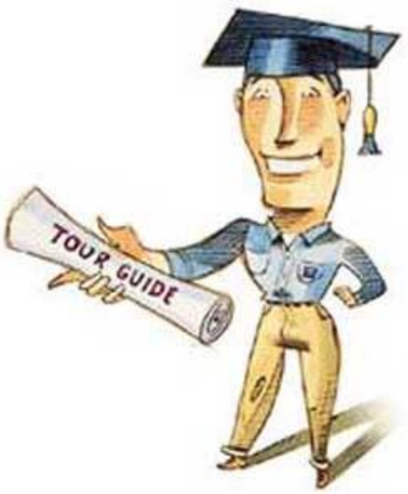
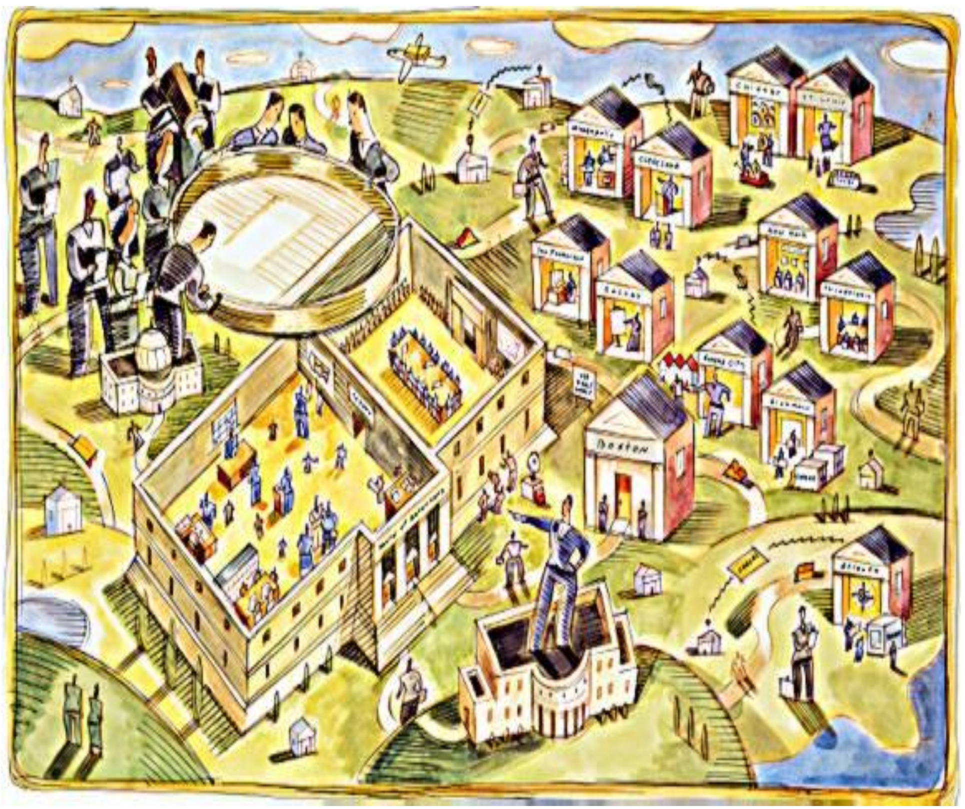
The Federal Reserve In Action



What is the Fed?



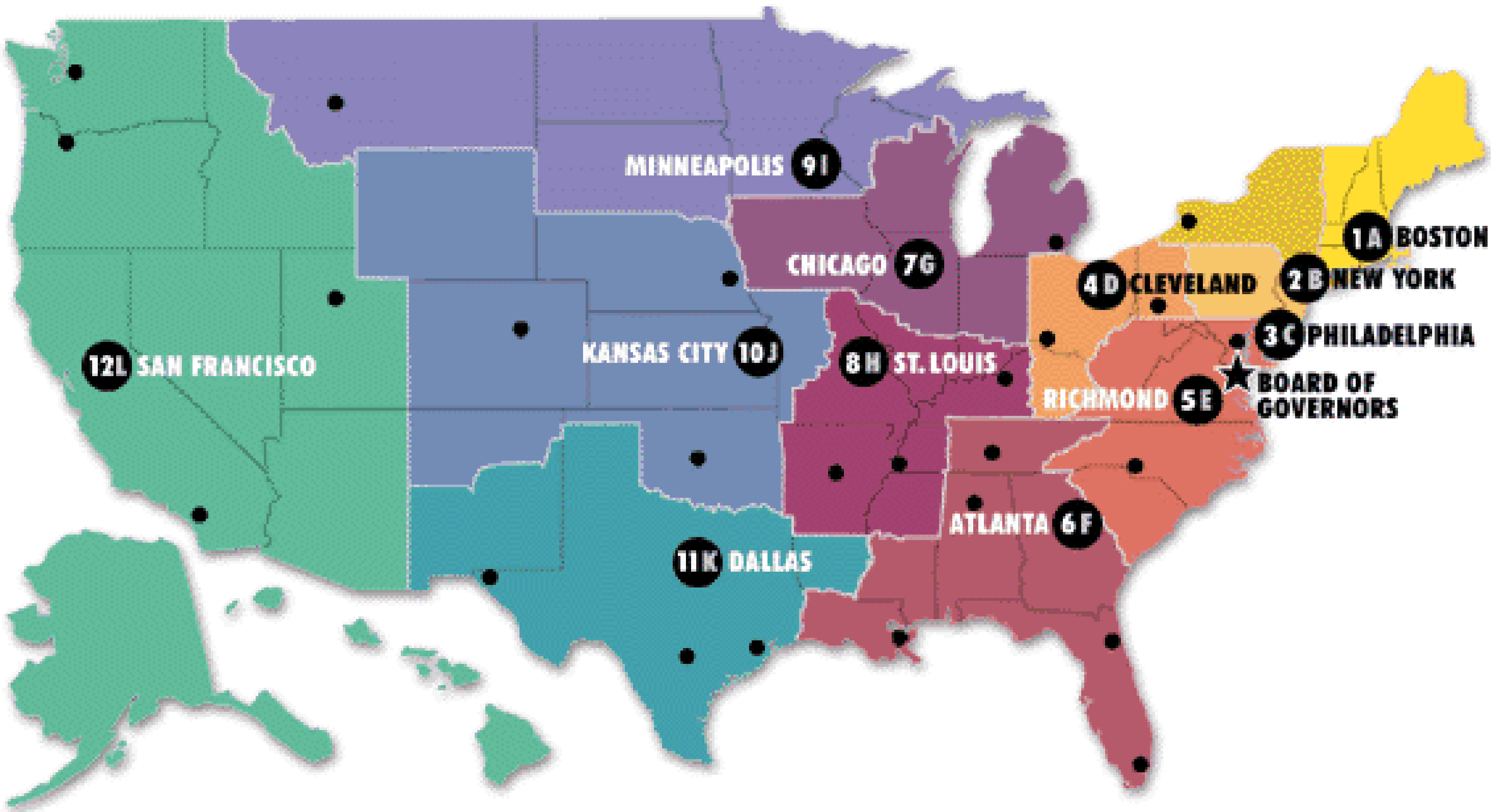
- Central bank of the United States
- Established in 1913
- Purpose is to ensure a stable economy for the nation

Federal Reserve System Structure

- Board of Governors

- 12 Reserve Banks

Where is my Fed?



Role of Federal Reserve Banks

- Distribute the nation's currency and coin
- Supervise and regulate member banks and bank holding companies
- Process and clear payments
- Serve as banker for the U.S. Treasury
- Contribute to **monetary policy**making through participation in the FOMC

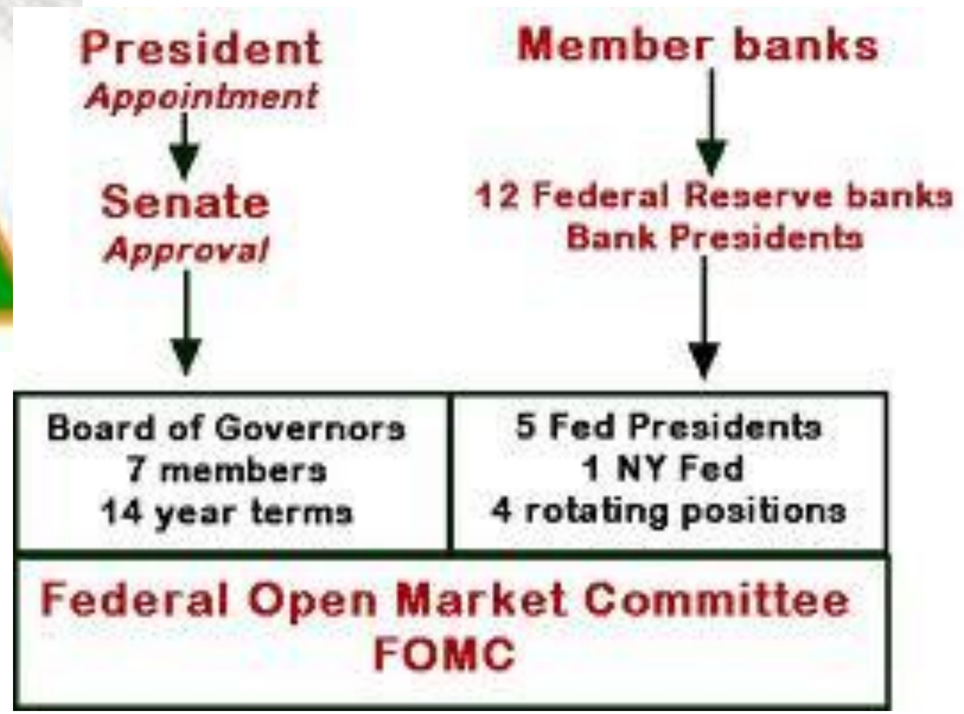
Federal Reserve System Structure

- Board of Governors

- 12 Reserve Banks

- Federal Open Market Committee


Bank Presidents
Boards of Directors
Advisory Councils
Functions
BOARD OF GOVERNORS
FEDERAL OPEN MARKET COMMITTEE
FEDERAL RESERVE BANKS
MEMBER BANKS
OTHER DEPOSITORY INSTITUTIONS
AMERICAN PEOPLE


President
Appointment
Senate
Approval
Member banks
12 Federal Reserve banks
Bank Presidents
Board of Governors
7 members
14 year terms
5 Fed Presidents
1 NY Fed
4 rotating positions
Federal Open Market Committee
FOMC

Federal Open Market Committee

- Sets and directs U.S. monetary policy
- 19 members
  - 7 Governors, 12 Bank Pres.
- All governors and 5 Pres. Vote on Monetary Policy
- Final interest rate decision is made by the 12-member Federal Open Market Committee (FOMC)

Monetary Policy

- Policy changes that affect the nation’s supply of money and credit.

Quick note about how banks work

- Banks hold people's money when they aren't using it

- This causes money to "pile up"

  - Since the bank knows the people aren't coming for their money anytime soon, they can lend it out to others

Interest rates

- The bank “thanks you” for the ability to lend by paying you interest on your savings account

- Example: I keep $1,000 in a savings account from January to December.

- The bank pays me 2% interest so at the end of the year I have $1,020 in the bank!

When the bank makes a loan…

- …they charge people MORE than 2% interest.

- Example: Joe borrows $1,000 to buy some garage doors. The bank charges him 5% interest on the loan.

- Joe must repay $1,050 to the bank. They pay me $20 (on my savings account) and keep the other $30 as profit.

Key Tools of Monetary Policy

- Discount Rate
  - The interest rate charged by the Federal Reserve to banks that borrow on a short-term (usually overnight) basis

Discount

- BofA wants to borrow some money in order to make a large loan to a major Corporation
- They have 2 options

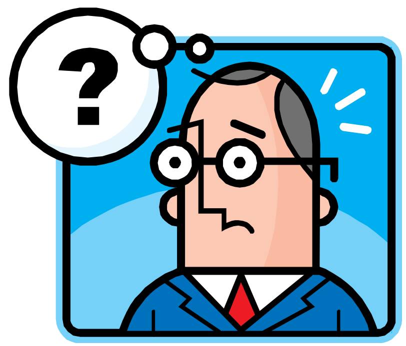
  Borrow from another Bank

WELLS FARGO

Borrow from the FED

PHOTO: JOHN R. COUGHLIN

WELLS FARGO



- Will lend at the

FEDERAL FUNDS RATE (currently .25%)

- Will lend at the

DISCOUNT RATE (currently .50%)

- **Well's Fargo is cheaper, quicker, and won't question BofA**
- **The FED is more expensive, will take longer, and will want to see Bof A's recent ledger sheets**
- **Why would ANYONE want to borrow from the Fed?**

WELLS FARGO

•Will lend at the FEDERAL FUNDS RATE (currently .25%)

•Will lend at the FEDERAL FUNDS RATE (CHANGED TO .05%)

•Will lend at the DISCOUNT RATE (CHANGED TO .10%)

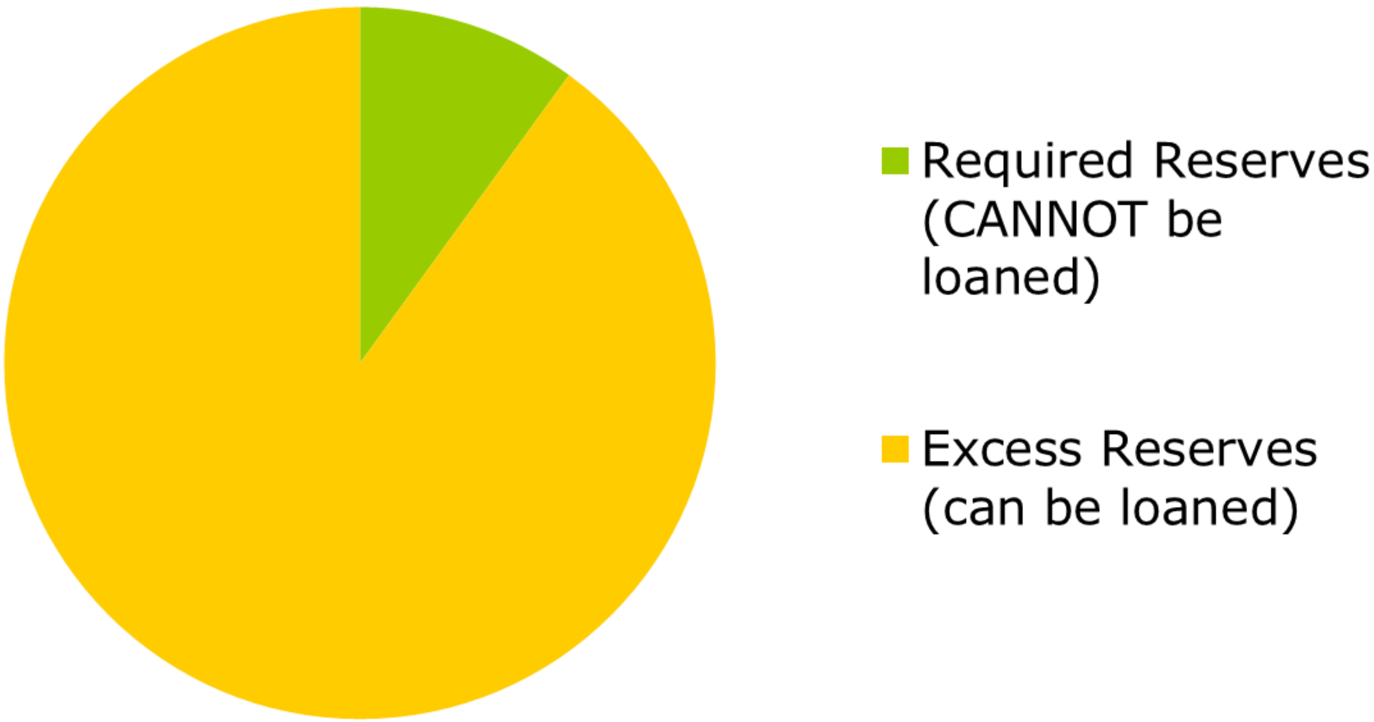
•If the FED LOWERS the discount rate, it may attract customers

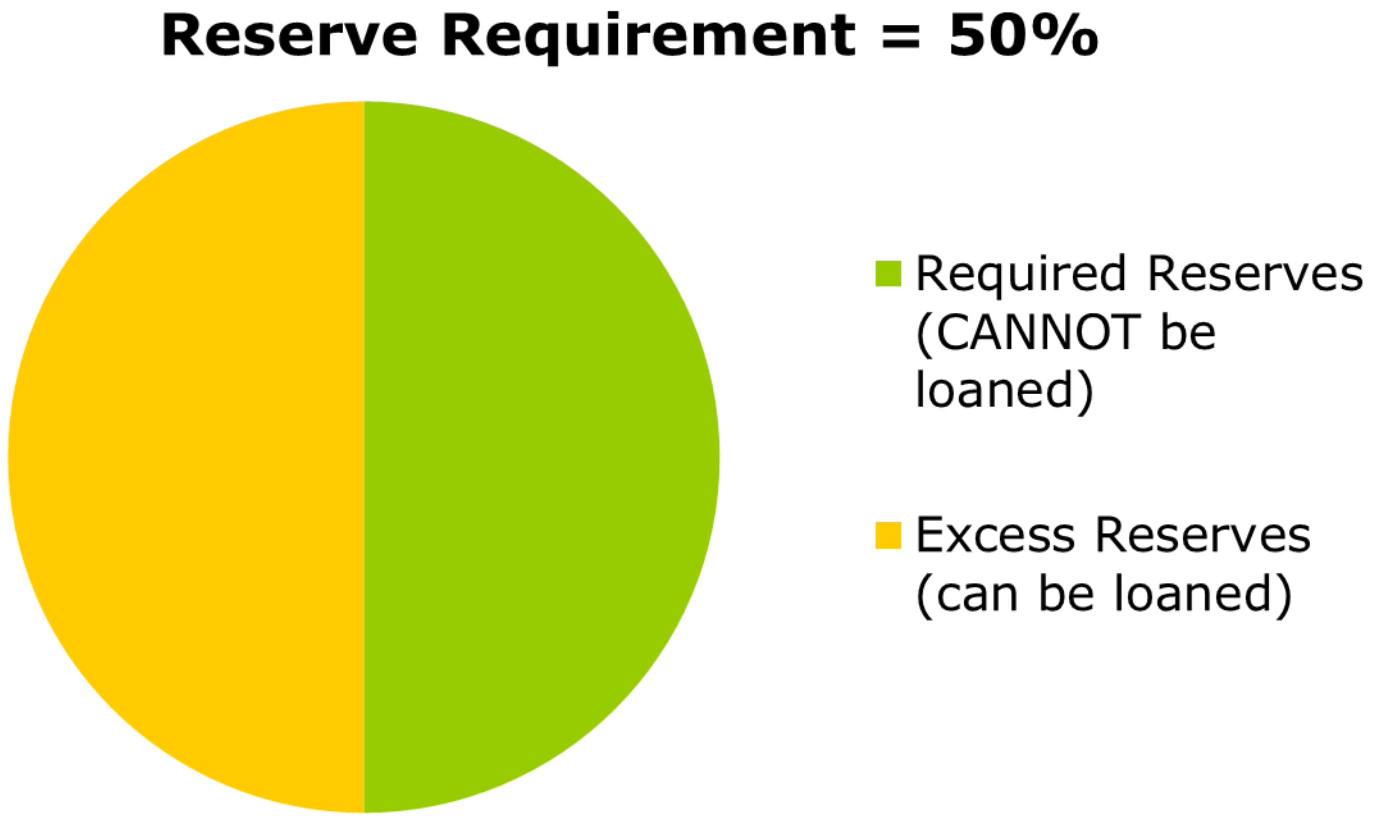
•Eventually Wells Fargo will need to lower it's rate to compete again

Key Tools of Monetary Policy

- Discount Rate
  - **The interest rate charged by the Federal Reserve to banks that borrow on a short-term (usually overnight) basis**
  - **This is the “cost” of money**
    - **Higher discount rate = slower economy, vice versa**
- Reserve Requirements
  - **The amount of money banks must keep on reserve at the Fed**
    - **Higher reserve requirement = slower economy**
- Open Market Operations
  - **Buying and selling Treasury securities between the Fed and selected financial institutions in the open market**
  - **Most important tool; directed by the FOMC**
    - **Buying bonds = bigger economy, selling = smaller**

Reserve Requirement = 10%



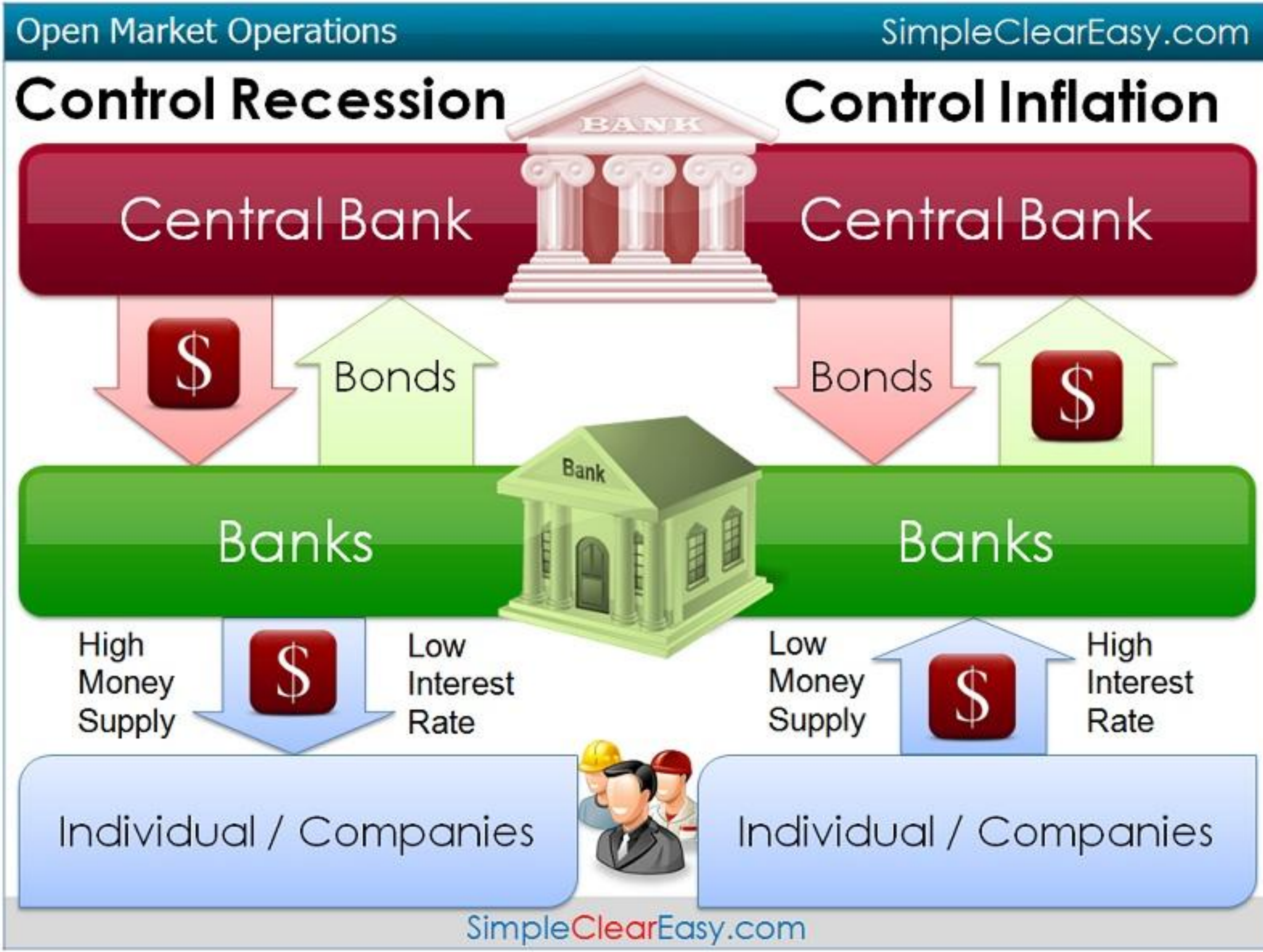

Reserve Requirement = 50%
Required Reserves (CANNOT be loaned)
Excess Reserves (can be loaned)

Open Market Operations

- The FED has bonds and money
- In a recession they **BUY** bonds from a bank, sending them money

Open Market Operations

- Now the bank has more money to lend!
  - Lower interest rates, more loans, more spending, more consumption, HIGHER GDP!!


Open Market Operations
SimpleClearEasy.com
Control Recession
Control Inflation
BANK
Central Bank
Central Bank
$
Bonds
Bonds
$
Bank
Banks
Banks
High
Money
Supply
$
Low
Interest
Rate
Low
Money
Supply
$
High
Interest
Rate
Individual / Companies
Individual / Companies
SimpleClearEasy.com

Goals of Monetary Policy